No. 7812.

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In the United States Circuit Court of Appeals
For the Ninth Circuit.

The Republic Supply Company of California, a corporation,
Complainant,
vs.
Richfield Oil Company of California, a corporation,
Defendant.

Security-First National Bank of Los Angeles, as Trustee, et al.,
Appellants and Cross-Appellees,
vs.
Universal Consolidated Oil Company, a California corporation,
Intervenor, Appellee and Cross-Appellant,
The Chase National Bank of The City of New York, et al.,
Appellees.

BRIEF OF APPELLEE UNIVERSAL CONSOLIDATED OIL COMPANY.

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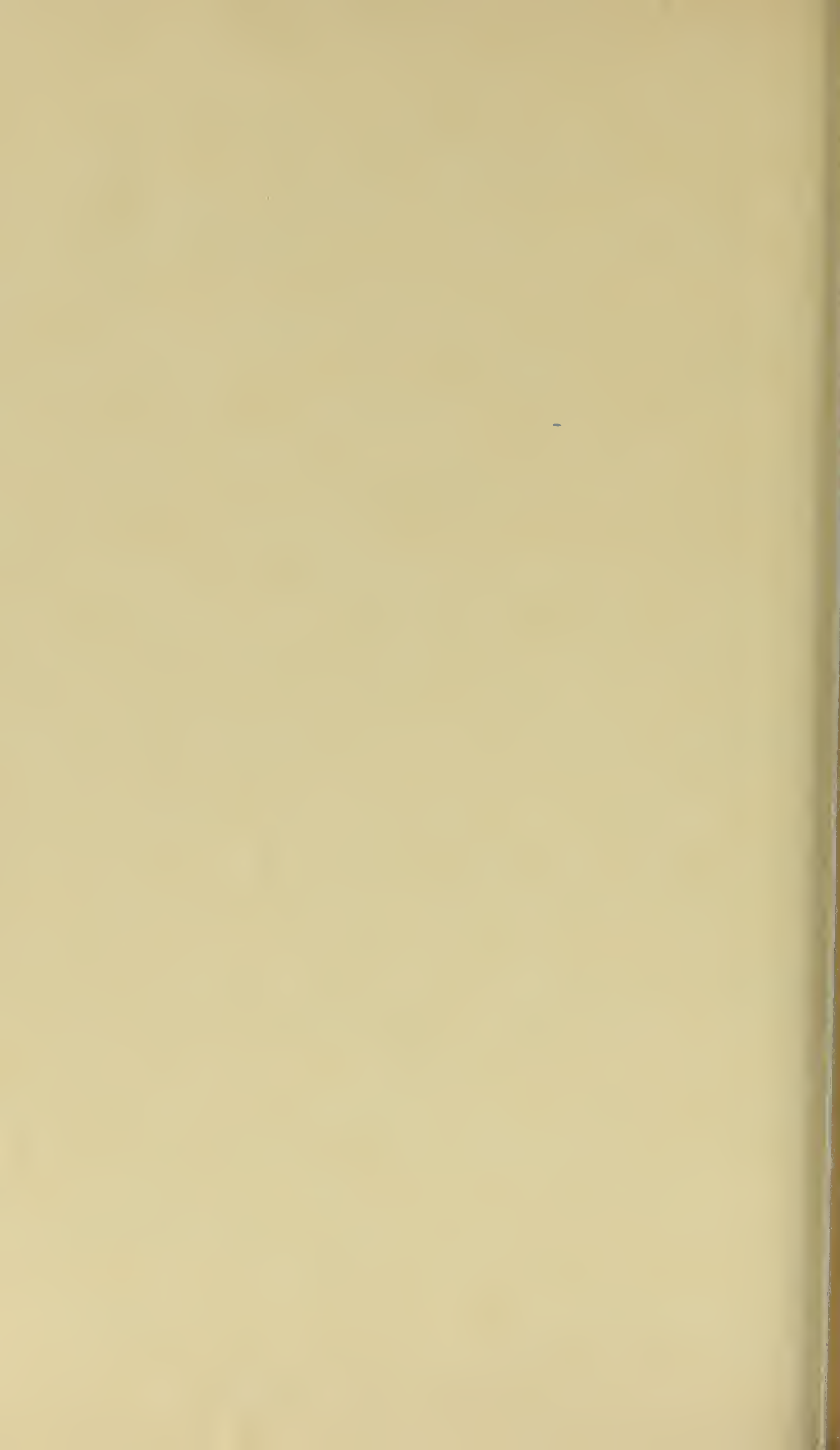

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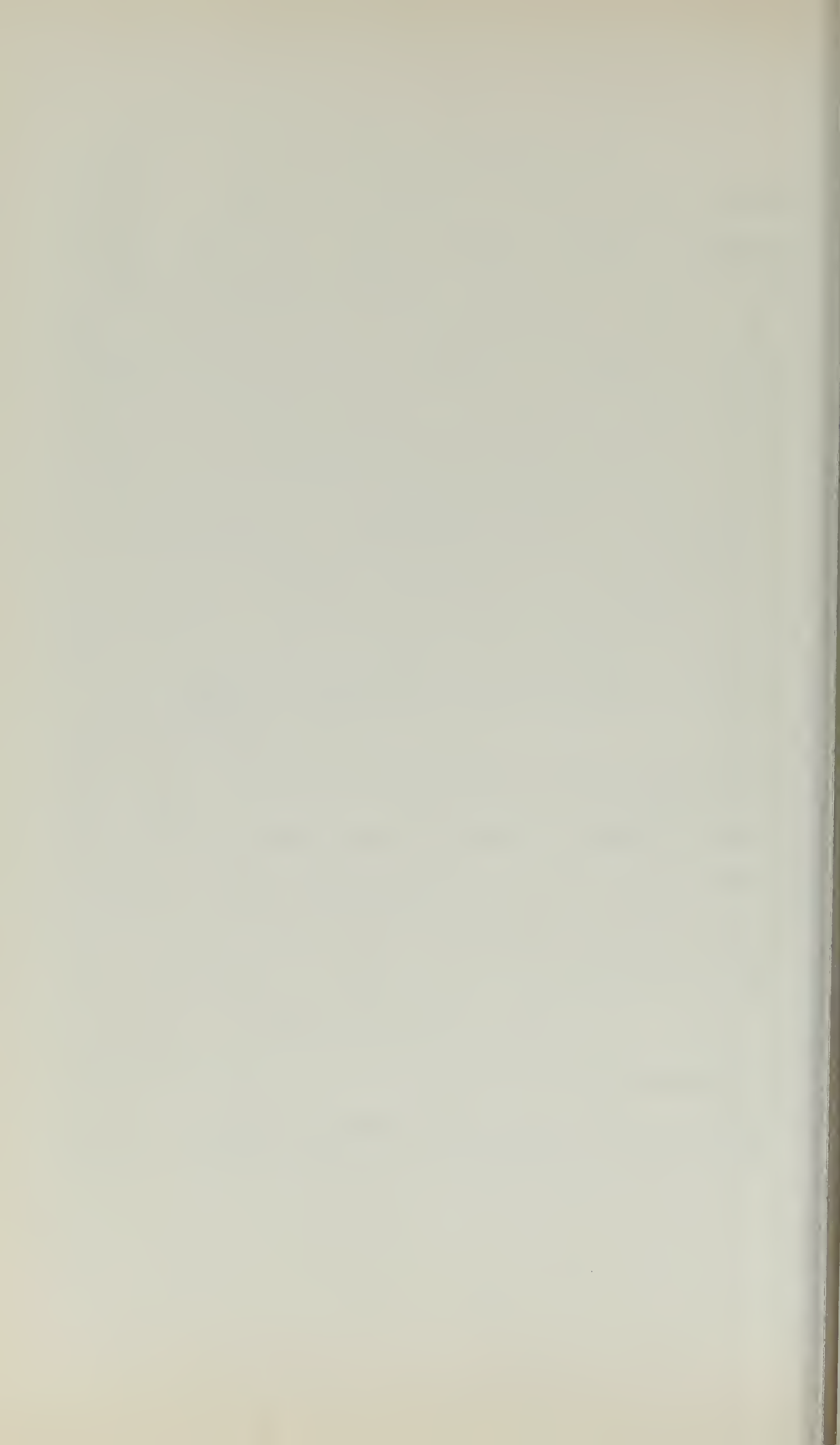

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BRIEF OF APPELLEE UNIVERSAL CONSOLIDATED OIL COMPANY.

PRELIMINARY STATEMENT.

Because of the fact that Universal Consolidated Oil Company* heretofore filed its brief herein as a cross-appellant we will, as far as possible, avoid a repetition of any matters discussed in that brief. We respectfully refer this court to the preliminary statement and statement of the case contained in our brief as cross-appellant for a more complete picture of the facts involved and the events that led up to the present matter.

The brief of cross-appellant presupposed that all matters—save and except the question of the proper method of determining the lowest balance in the Security Bank—were correctly decided in favor of cross-appellant by the Special Master and the District Court. The present brief of appellee will be devoted only to answering such of the matters voiced by the appellants that refer to the propriety of the action of the Special Master and the District Court in awarding appellee the relief heretofore given—but not as to the amount of such relief.

It is to be noted that appellants' brief occupies a role not ordinarily taken by such a document—namely, that brief is attempting to answer certain briefs filed by Universal before the Master and District Court at the time of the hearings. We feel, however, that appellants have not in their brief added anything more to the arguments presented before the lower tribunals, and that appellants' claim should likewise be held untenable by this court.

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* For the purposes of convenience, and following the same procedure in our brief as cross-appellant, occasionally in this brief, William C. McDuffie is referred to as Receiver; Richfield Oil Company of California is referred to as Richfield; Universal Consolidated Oil Company is referred to as Universal, and Security-First National Bank of Los Angeles is referred to as Security Bank. (All italics are ours unless otherwise noted.)

In answering the brief of appellants, we propose to follow substantially the order outlined in their brief, but we will present the argument according to the following outline:

1. Where trust funds are commingled with those of a defaulting trustee, and moneys are withdrawn from this fund with which property is purchased, and the balance of the funds are thereafter dissipated, then the *cestui que trust* is entitled to a lien upon the property so purchased.

(a) The principle of the case of *In re Oatway* not only has been applied by our Federal Courts, but every reason and every authority requires that it be applied in the instant case.

(b) No case decided by the Supreme Court has ever disapproved of the principles announced in *In re Oatway.*

2. When the *cestui* has clearly traced its trust money into a fund in the hands of the defaulting trustee, has identified certain specific properties purchased by the trustee from that commingled fund; and has proved a dissipation of the balance, then the burden of going forward with the evidence and proving that it was not the money of the *cestui* which purchased the property rests on the trustee.

3. The right of Universal to trace its money is limited by the lowest balance reached by the Richfield bank account between the date of misappropriation and the date of the purchase of the property.

(a) The proper minimum balance that should have been used by the Special Master and the District Court was either the closing daily balance or the lowest posted balance. This point is fully developed in our brief as cross-appellant.

ARGUMENT.

I.

Where Trust Funds Are Commingled With Those of a Defaulting Trustee, and Moneys Are Withdrawn From This Fund With Which Property Is Purchased, and the Balance of the Funds Are Thereafter Dissipated, Then the Cestui Que Trust Is Entitled to a Lien Upon the Property So Purchased.

Appellants concede that the law upon tracing of commingled trust funds into the hands of a wrong-doing trustee has undergone great changes from its original interpretation. As business transactions became more and more involved, the difficulty of tracing such funds quite naturally increased, so equity courts, in an effort to do substantial justice, have wisely relaxed the burdens imposed upon the injured *cestui* to assist him in his efforts to trace his funds. In doing so, these courts have adopted certain presumptions to aid him in the identification of the funds.

While they recognize that the law has undergone great changes from the days in which the *cestui* was required to identify the identical dollars abstracted from him, appellants wish the court to stop the progress of that law and to revert to those rigorous rules adopted in the Eighteenth and early Nineteenth Centuries.

Though the rules set forth by the courts in that early time were sufficient, in view of the nature of business transactions of that period, to do substantial justice, they will not suffice today because of the increased complexity of those transactions. The nature of present day business, and the amount of credit utilized by our present day

corporations in their every day business operations would, under those early rules, prevent almost every injured *cestui* from receiving the judgment to which he is entitled under the only conditions in which he needs it, namely, when the trustee is insolvent.

If the early law still applied, all that the trustee would have to do to defeat the recovery of the defrauded *cestui* would be to place the money in an account containing his own money as well and make purchases of property from that commingled fund. The defrauded *cestui* would thereupon be forced to share equally with the general creditors.

Fortunately, for defrauded *cestuis que trustent,* this *rigorous* rule of definite earmarking has been considerably relaxed by modern courts of equity. Any attempt to do substantial justice required such a relaxation. Money has no earmarks. Each dollar is the same as any other; so it would be beyond human power to say whether a particular dollar used to buy a piece of property was one of the *cestui's* dollars or one belonging to the trustee.

Appellants also admit that if Universal were merely attempting to trace its trust funds into the bank account containing the commingled moneys of Richfield and Universal, and thus attempting to reclaim same, Universal would *not* be required to identify the *identical* dollars in the account as belonging to it. (p. 50, appellants' brief.) This result would likewise be conceded notwithstanding the fact that in the meanwhile Richfield deposited in its bank account the eighty-odd million dollars, and notwithstanding the numerous withdrawals therefrom.

The result thus conceded by appellants, were the question merely one of money in the bank, would have been

arrived at without Universal having to do more than to produce testimony that its money had been misappropriated, that this money had gone into the commingled bank account, and that a certain balance came into the hands of the Receiver without any intervening exhaustion.

Appellants apparently then contend that because property was purchased with money from the commingled account, appellee must fail in its claim simply because it could not identify the *particular* dollars that went out of the commingled fund and into the property. If it is not necessary to identify the particular dollars that remained in the bank account that came into the Receiver's hands, no reason suggests itself why it should be necessary to identify the particular dollars that went into the property purchased from the commingled account. There can be no distinction in these two cases—the equities are identical in both, and similar proof should effect like results.

When Universal's money was misappropriated and deposited in the Richfield bank account, it is our claim, and it is supported by authorities, that the lien of Universal extended to the entire amount in the bank account—subject only to the minimum balance. The commingling of the money in Richfield's account did not in any wise extinguish the rights of appellee to claim the money as a trust fund, and so long as the trust money remained in the commingled fund, the effect thereof was to give appellee a prior lien upon the *entire* fund.

See:

Brennan v. Tillinghast, 201 Fed. 609 (C. C. A. 6th);

Frelinghuysen v. Nugent, 36 Fed. 229 (C. C. D. N. J.);

Ellerbe v. Studebaker Corp., 21 F. (2) 993 (C. C. A. 4th);

City of Miami v. First Nat'l Bank, 58 F. (2) 561 (C. C. A. 5th).

This doctrine has been consistently followed by our Federal Courts since the opinion of Sir George Jessel in the leading case of *Knatchbull v. Hallett,* 13 Ch. Div. 696 (1879) where it was stated:

> "*If a man mixes trust funds with his own, the whole will be treated as the trust property except so far as he may be able to distinguish what is his own.* . . . If a man has £1000 of his own in a box on one side and £1000 of trust property in the same box on the other side, and then takes out £500 and applies it to his own purposes, the court will not allow him to say that that money was taken from the trust fund. The trust must have its £1000 so long as a sufficient sum remains in the box. So, here, Edwards could not be allowed to say that the £284 deposited in the Bank of England was his own, and that the trust portion of the fund was that which he took abroad with him." (13 Ch. Div. 719.)

Thus having a lien on the money in the commingled fund, it requires no magic for a court of equity to permit that lien to follow into property purchased with the money in the fund. The property so purchased is merely the money existing in a substituted form. As appropriately stated by the Master in his report:

> "No change in the state or form of the trust property can divest it of its trust character; a court of equity will follow it through all the transmutations it may undergo in the hands of the trustee, and it

> may be pursued and recovered by the beneficial owner as long as it can be traced or identified, either in its original state or in some altered or substituted form. And this applies as well after the insolvency of the trustee as before. First Nat. Bank v. Armstrong, 36 Fed. 59, 61, 62, C. C. S. D. Ohio; St. Augustine Paint Co. v. McNair, 59 Fed. (2d) 755, 757, D. C. S. D. Fla.; Kemp v. Elmer Co., 56 Fed. (2d) 657, D. C. S. D. Cal.; *In re* J. M. Acheson Co., 170 Fed. 427, 429, C. C. A. 9; Board v. Strawn, 157 Fed. 49, C. C. A. 6; Peters v. Bain, 133 U. S. 670, 33 L. Ed. 696, 699." [Tr. p. 175.]

We do not contend that the facts in the cases cited on pages 48 to 54 of appellants' brief are *entirely* identical with the facts in the instant case. However, we submit that they show conclusively that the identity of a trust fund is not destroyed by its conversion from money to property; and they are also authority to show that a defrauded *cestui* need not, in order to establish a lien upon property so purchased, prove that such property was bought with the *very* dollars taken from him by the trustee.

Thus, in the case of *In re J. M. Acheson Co.,* 170 Fed. 427, 429 (C. C. A. 9th) this court, in a decision by Judge Hunt, approved the doctrine that the *cestui* could recover property that had been purchased with commingled funds, and cited with approval, *City of Spokane v. First National Bank*, 68 Fed. 982 (C. C. A. 9th) in which it was held that:

> "Where a trustee had wrongfully mixed and commingled with his own funds moneys known to be trust funds, and thereafter wrongfully invested such funds in securities which remained in his hands, the

owner of such funds was entitled to follow the same *in the form in which they had been converted* and could impress a trust for his benefit." (170 F. 429.)

The mere fact that these cases involved rulings on the pleadings does not detract in the slightest from the principle of law therein enunciated.

In addition to the cases cited in the Master's Report, *supra,* and to the same effect, are a number of cases in the State Reports, as well as other Federal cases.

See the following cases:

Equitable Trust Co. v. Conn. Brass & Mfg. Corp., 10 Fed. (2d) 913 (C. C. A. 2.);

Southern Cotton Oil Co. v. Elliotte, 218 Fed. 567 (C. C. A. 6);

Smith v. Township of Au Gres, 150 Fed. 258 (C. C. A. 6);

Erie R. Co. v. Dial, 140 Fed. 689 (C. C. A. 6);

Frith v. Cartland, 2 H. & M. 417; 71 Eng. Rep. 525 (1865);

Taylor v. Morris, 163 Cal. 717;

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Smith v. Combs, 49 N. J. Eq. 420, 24 Atl. 9;

Mass. Bonding Insurance Co. v. Josselyn, 224 Mich. 159; 194 N. W. 548;

Morin v. Kirkland, 226 Mass. 345; 115 N. E. 414;

Camden Land Co. v. Lewis, 101 Me. 78; 63 Atl. 523;

Gibson Co. v. Elze, 293 Pac. 958 (Colo.);
Spencer v. Pettit, 17 S. W. (2d) 1102 (Tex.);
Myers v. Baylor University, 6 S. W. (2d) 393 (Tex.);
Glidden v. Gutelius, 119 So. 140, 120 So. 1 (Fla.);
Byrom v. Gunn, 102 Ga. 565; 31 S. E. 560.

(a) The Principle of the Case of In re Oatway Not Only Has Been Applied by Our Federal Courts, but Every Reason and Every Authority Requires That It Be Applied in the Instant Case.

Appellants admit that the English courts have recognized an additional relaxation to the original rule requiring the tracing of identical dollars out of a commingled trust fund, and admit that the decision of Sir Matthew Joyce in the case of *In re Oatway,* L. R. (1903) 2 Ch. 356, would have been decisive in favor of Universal, had this controversy arisen in England.

In that opinion, the learned judge established what we respectfully submit is a clear statement of the rights of an injured *cestui que trust* who was in exactly the identical position that Universal maintains in the case at bar.

The facts in *In re Oatway* disclose that a decedent was a trustee of an estate. He had advanced 3000 pounds of the funds of the estate to a third party on security. The decedent thereafter sold the security for 7000 pounds, and placed this amount in his personal bank account. Later the decedent bought other stock for 2100 pounds and paid for it with the funds in his personal account. Subsequently the bank account was entirely dissipated.

Under these circumstances, the English court in language free from ambiguity, awarded the *cestui* the right to go after the stock purchased by the decedent, and pointed out that the defaulting trustee could not claim that the investment represented only his money. Joyce, J., said in this connection:

> "It is, in my opinion, equally clear that *when any of the money drawn out has been invested, and the investment remains in the name or under the control of the trustee, the rest of the balance having been afterwards dissipated by him, he cannot maintain that the investment which remains represents his own money alone, and that what has been spent and can no longer be traced and recovered was the money belonging to the trust.* In other words, when the private money of the trustee and that which he held in a fiduciary capacity have been mixed into the same banking account, from which various payments have from time to time been made, then, in order to determine to whom any remaining balance on any investment that may have been paid for out of the account ought to be deemed to belong, the trustee must be debited with all the sums that have been withdrawn and applied to his own use so as to be no longer recoverable, and the trust money in like manner be debited with any sums taken out and duly invested in the names of the proper trustees. The order of priority in which the various withdrawals and investments may have been respectively made is wholly immaterial." (L. R. (1903) 2 Ch. 360.)

At the time the stock was purchased by the defaulting trustee, there was a greater amount in the bank account than the amount of the trust funds for which the trus-

tee was accountable. An attempt was made to prevail upon the court to permit the trustee to retain the stock purchased on the specious argument that the trustee would have been entitled to withdraw the excess moneys in the bank account over the trust funds, and with that excess the trustee could have purchased the shares involved. By this means the trustee would, of course, nullify the right of the *cestui* to follow the stock purchased. In denying the trustee this right, and in favoring the *cestui*, Joyce, J., stated:

> "It was objected that the investment in the Oceana shares was made at a time when Oatway's own share of the balance to the credit of the account would have exceeded 2137 pounds, the price of the shares; that he was therefore entitled to withdraw that sum and might rightly apply it for his own purpose; and that consequently the shares should be held to belong to his estate. To this I answer that he *never* was entitled to withdraw the 2137 pounds from the account, or, at all events, that he *could not be entitled to take that sum from the account and hold it with the investment made therewith free from the charge in favor of the trust,* unless or until the trust money paid into the account had been first restored, and the trust fund reinstated by due investment of the money in the joint names of the proper trustees, which was never done." (L. R. (1903) 2 Ch. 360.)

That case so closely approximates the facts in the instant case that it is no surprise that appellants ask that its doctrine be not enforced. They erroneously assert that these justifiable principles promulgated by the English court in the *Oatway* case have never been adopted by the Federal Courts of this country.

Bearing in mind the overwhelming approval that has been given by our courts to the principle announced in the case of *Knatchbull v. Hallett, supra,* and considering that the *In re Oatway* case, *supra,* is but a development of the former case, it is understandable why our Federal Courts and State Courts have already accepted the law as announced in *In re Oatway, supra.*

Thus the case of *Brennan v. Tillinghast,* 201 Fed. 609 (C. C. A. 6th) *unequivocally* adopts the principles of *In re Oatway.* The *Brennan* case discloses that plaintiff therein had borrowed money from the Ironwood Bank, and deposited with that bank certain stock as collateral. In violation of its agreement, the Ironwood bank sold this stock for $3558.00, which it then deposited to its credit in an open account in the Duluth bank. Thereafter, and from time to time, the Ironwood bank deposited additional sums in the Duluth bank and drew a number of drafts against the credit so established. However, at all times during the period in question, the open account of the Ironwood bank in the Duluth bank, after including all deposits made and deducting all drafts drawn, showed a balance in excess of the $3558.00 at the end of each day. During the period in which the balance exceeded the amount of the trust fund, the Ironwood bank drew drafts against its open account in the Duluth bank, aggregating $2807.00, and deposited the proceeds thereof in its cash account in its own bank. At the time it drew those drafts, its credit in the Duluth bank was greater than the amount of the trust, but before insolvency that credit was overdrawn.

The court held that plaintiff could trace $2807.00 from the Duluth bank to the Ironwood bank, and granted plain-

tiff a preferential claim for that sum. Judge Sanford, after referring to the generally accepted rule of the *Hallett* case, states:

> " . . . This rule of presumption has no application where the evidence shows that the first moneys drawn out of the mingled fund by the *tort feasor* were not in fact dissipated by him at all, *but were merely transferred, in a substituted form,* to another fund retained in his own possession." (201 Fed. 614.)

Such substituted form need not be limited to cash, but, manifestly, property purchased with trust funds would likewise be in a substituted form. The application of the *Brennan* case would be just as pertinent had the fiduciary bank therein purchased stocks or bonds with the proceeds of the drafts.

Judge Sanford continued and pointed out that in such a case the trust attaches to the substituted form in which the property is retained by the fiduciary,

> ". . . and that the right to follow the trust in such form is *not lost* by reason of the fact that the *tort-feasor* thereafter draws out and spends for his own purposes the balance of the fund in which the trust money was originally mingled. *The English case of In re Oatway,* L. R. 2 Ch. 356, 359, *directly sustains this view.*" (201 Fed. 614.)

The last sentence, which has been italicized by us, was left off the quotation submitted by appellants in their brief on page 61.

Appellants endeavored to distinguish the facts and circumstances of *Brennan v. Tillinghast* from those in the

instant case in an effort to show that our federal equity law was not expanded to the degree to which *In re Oatway* had expanded the law of England. They claim that the reference therein to the *Oatway* case may be disregarded because such reference was not absolutely necessary to the decision. Nevertheless the court actually made the citation: actually considered that the case of *In re Oatway* was a correct statement of the federal equity law as applied to a situation such as the one presented in the case at bar: and *actually relied upon the English case.*

The same unavailing effort was made by appellants to overcome the effect of the case of *In re Pacat Finance Corp.*, 27 Fed. 2nd 810 (C. C. A. 2nd). That case is likewise an out and out approval of the doctrine of *In re Oatway*.

The facts disclose that Pacat was in the business of buying and selling foreign exchange, and subsequently was adjudged a bankrupt. One Berardini had paid Pacat money in New York on numerous occasions with directions to pay an equivalent sum in lire to Berardini's business place in Naples. 750,000 lire remained unpaid by Pacat under this arrangement at the date of the bankruptcy.

When Berardini paid Pacat for the 750,000 lire, which were never delivered, Pacat deposited the checks therefor in its general account. Berardini did not claim any interest in the balance in that account, but showed that Pacat had sent checks for 3,000,000 lire that were deposited to Pacat's credit with Credito Italiano right after Berardini's payments, of which amount 92,000 lire was on hand at the time of the bankruptcy.

Berardini first sought to establish an express trust in the specific lire remaining in Pacat's possession, but this attempt was unsuccessful. The court, however, did decide that a constructive trust had been established and as a result thereof gave Berardini the 92,000 lire which were held by Pacat at Naples, being the balance of the 3,000,000 lire.

The court, in deciding that the balance of those lire in Credito Italiano were held by virtue of a constructive trust, said:

> "While Berardini's dollars cannot *be literally traced* into any of these lire credits, *the applicable principle is that stated by Joyce, J., In re Oatway,* L. R. (1893) 2 Ch. 356, 359: '. . . It is, in my opinion, equally clear that when any of the money drawn out has been invested, and the investment remains in the name or under the control of the trustee, the rest of the balance having been afterwards dissipated by him, he cannot maintain that the investment which remains represents his own money alone, and that what has been spent and can no longer be traced and recovered was the money belonging to the trust.' " (27 F. (2d) 813.)

Though counsel in their brief contend that this case is distinguishable for the reason that the money of the *cestui* always remained money, the fact is that the money of the *cestui* was used to buy lire credits. Obviously lire credits are *not* money in the United States, and such a purchase required as complete a transformation of the original trust fund as existed in the instant case. We submit that the purchase of lire credits stands on no different basis than the purchase of more Universal stock or other property in the instant case.

As stated by Judge Learned Hand in a very able opinion in the case of *Primeau v. Granfield,* 184 Fed. 480, 484, a case later reversed by the Circuit Court of Appeals because the claimant did not come into equity with clean hands:

> "The language about presumed intent in Knatchbull v. Hallett, *supra*, which Sir George Jessel laid down with his customary vigor, was merely a way of giving an explanation by a fiction of the right of the beneficiary to elect to regard his right as a lien. That it is a fiction appears clearly enough in this case where Granfield could have had no intention about the investments as he meant to use all the money for himself anyway. To say that in such a case he will be 'presumed' to intend to take his own money out first is merely a disingenuous way common enough, to avoid laying down a rule upon the matter. This fiction in *Re Oatway* (1903) 2 Ch. Div. 356, would have brought the usual injustice which fictions do bring, when pressed logically to their conclusion. Logically, the trustee's widow, in that case, was quite right in claiming the first withdrawal, although the trustee had invested it profitably, and had subsequently wasted all of the fund which had remained in the bank. That was, of course, too much for the sense of justice of the court which awarded to the wronged beneficiary the investment, intimating that the rule in Knatchbull v. Hallett, *supra,* applied only where the withdrawals were actually spent and disappeared. If to that rule be added the qualification that if the first withdrawals be invested in losing ventures, then the beneficiary is to have a lien, if he likes, till he uses up that whole investment, and then

may elect to fall back for the balance upon the original mixed account from which the withdrawal was made, there is no objection, but it is a very clumsy way of saying that he may elect to accept the investment if he likes, or to reject it. The last is the only rule which will preserve to the beneficiary the option which he has when the investment is made wholly with his money." (184 Fed. 484.)

See, also:

Fiman v. State of South Dakota, 29 Fed. (2d) 776, 781. (C. C. A. 8th.)

The appellate courts of several states have adopted the foregoing doctrines. While we have no quarrel with the assertion of counsel that the federal courts are not bound by the decisions of the Supreme Courts of the several states, still we feel that those state decisions, when based upon a consideration of the general principles of law and equity, are entitled to consideration, particularly when one of those decisions is a decision of the state in which the transaction occurred.

In the case of *Mitchell v. Dunn,* 211 Cal. 129, defendant was appointed guardian of the estate of her brother, an incompetent. As such guardian she maintained two bank accounts, a personal one and a guardianship one; but no attempt was made by the guardian to keep the accounts separate. The guardian had purchased some real estate which she had taken in her own name but she had paid for same with a check on the guardianship account. Shortly after the purchase, the account rendered to the court by the guardian was approved and it showed therein an amount in excess of the amount of the purchase price

of the property. However, prior to the termination of the guardianship, the guardian had dissipated the entire remainder of the guardianship funds.

The court, in holding that the real property so purchased was trust property, said:

> "At any rate, the presumption in reference to withdrawals, in a contest between the *cestui* and trustee, based as it is, on a theory of right doing, cannot be indulged in to defeat the *cestui's* right of recovery when all the evidence shows a consistent course of conduct amounting to wrong doing. To permit the presumption to be used for that purpose would be to permit its use as a shield for wrongdoing, and that we are not inclined to do. . . . (211 Cal. 135.)
>
> "In the case at bar the plaintiff has sufficiently traced the trust funds. The specific piece of property involved was purchased with money taken from a fund containing trust moneys. All other moneys were dissipated. *The law will not permit the trustee to say that the only permanent investment made with moneys from the fund was with personal funds and that the dissipated funds belonged to the cestui.* Under such circumstances it must be held that the property was purchased with trust funds and that defendant holds the title in trust for plaintiff." (211 Cal. 136.)

Banks v. Rice, 8 Colo. 217; 45 Pac. 515, 517, was a case very similar in its facts to the instant case.

There plaintiff made a contract to supply defendant with Colorado Supreme Court Reports. Defendant was to sell the books and take out a 5% commission and remit the balance. Defendant failed to remit $434.00 which he converted to his own use, and mingled with his own

funds. With these commingled funds he paid the current expenses of his business and also purchased new goods and materials. There was a constant turnover of these goods, but a large stock of merchandise passed to the trustee on defendant's bankruptcy.

The court held that even though the stock was changed several times, the trust fund remained in the business and could be traced into the stock of goods which the trustee in bankruptcy held. They allowed a lien on those remaining goods because regardless of the changes the fund underwent as there was still a charge upon the property purchased with the commingled funds. The court said:

> "It will be presumed that, in drawing upon the consolidated fund for that purpose, it drew upon its own money, and used its own money, and that all the money of the petitioners was applied in the purchase of goods and is represented in the company's assets. In other words, the presumption, in the abscence of evidence, is that the petitioners' money was applied where it can be reached and not where it cannot be reached." (45 Pac. 517.)

In *City of Lincoln v. Morrison*, 64 Neb. 822, 90 N. W. 905, 909, Pound, C. (in rendering the opinion in that case), declared a trust upon certain warrants bought with a commingled fund consisting of trust money and money of the trustee, and said:

> "It will be remembered that after the city's money came into the bank it bought the warrants, using $1750 of the moneys in which the funds of the city had been mixed, and $35,000 borrowed on security of the warrants. The receiver contends that since

there was over $40,000 in cash in the bank at the time, of which but $6000 belonged to the city, it will be presumed that the $1750 was the bank's own money. Such would be the case, without doubt, had the bank withdrawn the money and dissipated it in some fashion. But it did not do this. . . . In accordance with the presumption that whatever was retained and not dissipated was the city's money, and not the bank's, these warrants and their proceeds in the hands of the receiver represent money to which the city has a prior claim, in which the general creditors have no right to share. The city's right to follow the money does not fail because no one can say what part of the cash on hand in the bank went into the warrants. The city had a charge upon the whole in any form in which the bank might keep it. When all was wasted except the warrants, that charge remained upon them, because they were a part of that fund, though in an altered form."

(90 N. W. 909.)

The matter is ably summed up by the author of the note in 82 *A. L. R.* at page 160, where it is stated:

"The presumption in question, being based upon a fiction invented solely for the protection of the *cestui que trust, should not be applied in such manner as to defeat his right.* The application of the presumption would have that effect in a case where the bank withdrew and preserved, by investment or in another fund, a part of the fund with which the trust fund had been commingled, and subsequently dissipated the residue of the commingled fund; and the *better view,* as pointed out by Professor Scott in

> 27 Harvard L. Rev. 125, 132, *is that the part of the common fund left after the first withdrawal, and later dissipated by the bank, will not be presumed to be or represent the trust fund.* In other words, in such a case, the part first drawn out will not be presumed to have belonged to the trustee."

To the same effect, but in different language, the Master reported:

> "It is contended that the estoppel above alluded to (that the first funds withdrawn are those of the trustee) applies to disbursements for all objects alike, the purchase of land as well as the purchase of an ice-cream soda. Applying this theory to the present case, Richfield must be held to have invested its own money in the property in question, and to have dissipated the trust money afterwards; because the conversion of trust money into other property would be a violation of its duty, and such a breach must not be imputed to it. Thus Richfield makes a clear gain, and the estoppel which was intended to protect the victim defeats him. If this development is necessary, equity may still refuse to follow it; but in my opinion it proceeds from a fallacy, and is not necessary. On the contrary, it is a *misapplication* of the doctrine, and is *indeed inconsistent therewith;* for the doctrine concerns the dissipation, not the retention, of the fund, and it is *immaterial* whether it be retained in one form or another.
>
> "When the trust money is segregated and so traced into property, it is admitted by all the cases (Peters v. Bain, 33 L. ed. 696, for example), that the property is but a substituted form, and takes the place of the money. If the owned money were similarly segregated and traced into property, the same would

of course be true; the property would be but a substituted form of the owned money. If there is no segregation, but the mixed fund is traced into property, the same still remains true; the property is but a substituted form of the mixed fund. If there was any trust money in the mixed fund, it remains in the substituted mixed form; and it remains there in the same order in which it lay in the mixed fund itself: *first for the benefit of the cestui, and first to be retained for him,* and only afterwards for the benefit of the holder, and only afterwards to be retained for him. *The cestui's money has not been dissipated at all; on the contrary, it has been retained for him, but in another form.* The holder of the mixed fund might invest the whole thereof in bonds at the same time; if the contention were sound, that would defeat the cestui's title as effectually as would a dissipation of the whole fund at one turn of the roulette wheel; but it is obvious that no such result would follow: the cestui's money would still be in the bonds, to the same extent that it was in the fund. In the case of a partially invested mixed fund, the estoppel does not come into play at all, any more than it does in the case of a wholly invested or wholly undissipated fund. It is accordingly *repugnant* to the rule itself, and certainly not a necessary consequence thereof, to reward the guilty and penalize the innocent in the manner proposed.

"Moreover, if there were such a thing as an estoppel which concludes the opposite party instead of the one nominally estopped, it should be frankly abandoned by a court of equity." [Tr. pp. 178, 179.]

(b) No Case Decided by the Supreme Court Has Ever Disapproved of the Principles Announced in In re Oatway.

It is the contention of appellants, in effect, that the two cases of *Peters v. Bain,* 133 U. S. 670, 33 L. Ed. 696, and *Schuyler v. Littlefield,* 232 U. S. 707, 58 L. Ed. 806, practically dispose of the entire case adversely to the claims of Universal.

In considering these cases, it is important to bear in mind the language of Chief Justice Marshall in *Cohens v. Virginia,* 6 Wheaton 265, 5 L. Ed. 257, 290:

> "It is a maxim not to disregarded, that general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected, but ought not to control the judgment in a subsequent suit when the very point is presented for decision."
>
> (5 L. Ed. 290.)

As a matter of fact, both of the cases cited by appellants *support* the general position claimed by appellee, and an examination of their facts will readily show that they do not tend to defeat the recovery of Universal.

The case of *Peters v. Bain, supra,* admittedly permits a lien to be applied on property purchased with trust funds, and in that case where the money was segregated, the tracing into the property was complete. As there pointed out, the property *was but a substitute in form and took the place of the money.*

As to the second transaction in the *Peters* case, the court properly disallowed the attempt to trace the trust funds under the extremely complicated facts of that case. These funds, as pointed out, "*may or may not* have been made up in part of what had been wrongfully taken from the bank."

In addition to the facts quoted by appellants, the following facts are pertinent in the *Peters* case: The books of Bain & Bro. were entirely unreliable; no general ledger was kept; and transactions involving large amounts were kept only on memorandum slips and were explainable only with the aid of one of the Bains. "Everything, so far as Bain & Bro. were concerned, was found in the greatest confusion."

In commenting on the above situation in the *Peters* case, the Master in his report, stated:

> "There was thus before the court nothing but the bare fact that money had been received and money had been invested. It was impossible to ascertain any of the facts regarding the account *which are shown in the present case.* . . . When and in what items the moneys were received from the bank, when and in what items other moneys were received and commingled with the former, whether the mingled account was at any time exhausted, what, if any balance, remained therein at any time, what, if any, was the lowest balance at any time, when and in what amounts and in what properties investments were made from the mingled fund, whether a low balance was exhausted at any time by an investment, what, if any, part of the trust money remained after an investment for application on a subsequent investment,—*none of these things was shown, nor could*

they be shown; and it was necessary to show them, on any theory of the case. *They have been shown in the present case with precision.* The question of applying the principle here relied on did not present itself in the Bain case. It was not mentioned; and for the reason that the case lacked the facts upon which alone the question could arise. *The point now under discussion was accordingly not involved, and could not be involved.* There is, in my opinion, nothing in Peters v. Bain which prevents the application of the rule of *In re* Oatway and Brennan v. Tillinghast." [Tr. pp. 186, 187.]

The case of *Schuyler v. Littlefield, supra,* is the principal authority for the rule that trust funds deposited in the trustee's bank account and thereafter dissipated cannot be treated as reappearing in the sums subsequently deposited after the depletion of the original deposit. Thus the Supreme Court states:

> "The case involves an application of the rule that where one has deposited trust funds in his individual bank account, and the mingled fund is at any time wholly depleted, the trust fund is thereby dissipated, and cannot be treated as reappearing in sums subsequently deposited to the credit of the same account." (58 L. Ed. p. 807.)

In tracing the misappropriated funds in the present case, we have at all times adhered strictly to this doctrine by the recognition of the low balances, and have made no effort to charge any of the funds which subsequently appeared in the bank from other sources and replenished the deposit.

The difficulty of the court in the *Schuyler* case was in determining the time of the certification of a certain check which wholly depleted the account in the bank. Unless it could be proved that the check was certified before the deposit of the *cestui's* fund, the fund was entirely dissipated. The *cestui* failed in his proof as is more fully shown by the opinion of the Circuit Court in the same case, 193 Fed. 30.

The cited case has an additional complication in that the controversy was almost entirely between persons standing in the same position. That is, most of the adversary parties were those for whom the brokers were trustees. The court expressly refused to decide whether all the *cestuis* could have, by joining together, followed their total funds into the asset purchased, but held that between one *cestui* and another, the burden of proof was not sustained.

As a last resort in the cited case, the plaintiff therein endeavored to establish a claim against collateral that was released by the payment of certain loans for which the collateral had been given as security. There was no effort to show that any of the commingled funds were used in purchasing this collateral.

As pointed out in *In re Brown,* 193 Fed. 30,

> "Whether it (the $266,000 check) had actually been deposited before the loans were paid is not shown. If it were not deposited until afterwards, it certainly was not used to pay them off." (193 Fed. 33.)

Thus, the *cestui* in the *Brown* case wholly failed to show that at the time the loans secured by the collateral were paid off, his money was in the bank account.

On the contrary, we have in the instant case been very meticulous in showing that Universal's money was in the bank account at the time when each of the assets claimed was purchased.

In every instance where we have sought to follow a particular asset, the total fund was not dissipated, but there was at least that much money of the commingled funds remaining in the bank. At no time when any asset which we are seeking to follow, was purchased, had the balance in the account prior to the purchase, fallen below the amount expended for that particular asset.

It thus appears that the two cases, on which appellants chiefly rely, support the legal position for which we contend, but the judgment in those cases were against the *cestui* for failure of proof. No such failure exists in the case at bar.

Appellants in further support of their contention, that the dollars used to buy property must be identified as being the identical coins which were put into the commingled account, cite the case of *Empire State Surety Co. v. Carroll County*, 194 Fed. 593. In that case, as in *Schuyler v. Littlefield,* and *In re Brown,* the controversy was not *solely* between the *cestui* and the insolvent creditor; but one depositor was attempting to obtain a preference over all the depositors who had been likewise defrauded into depositing their money in ignorance of the bank's insolvency. The court prefaced that portion of the opinion in which it denied the preference with a statement that showed clearly the distinction, saying:

> "A *cestui que* trust who is the equitable owner of his fund for one sound reason is as much entitled to it as another who is the equitable owner of his

fund for many sound reasons, and the latter is entitled to *no preference* over the former in payment out of a common fund in which the trustee has commingled them." (194 Fed. 603.)

Appellants also cite in support of their position the case of *Board of Commissioners v. Strawn,* 157 Fed. 49, C. C. A. 6. We respectfully submit, however, that the opinion in that case was superseded by *Brennan v. Tillinghast,* 201 Fed. 609, also decided by the Circuit Court of Appeals of the Sixth Circuit.

II.

When the Cestui Has Clearly Traced Its Trust Money Into a Fund in the Hands of the Defaulting Trustee, Has Identified Certain Specific Properties Purchased by the Trustee From That Commingled Fund; Has Proved a Dissipation of the Balance, Then the Burden of Going Forward With the Evidence and Proving That It Was Not the Money of the Cestui Which Purchased the Property Rests on the Trustee.

Counsel for the appellants have depoted a considerable portion of their brief to an argument that a mere showing that trust funds have gone to swell the assets of an insolvent is insufficient to establish a preferential lien, and though there are Federal cases that support this doctrine, we have at no time claimed that we were entitled to a recovery upon that basis. We admit that under the generally accepted principles of law a *cestui,*

in order to establish his right to a preferential lien, must trace his trust funds into property in the hands of the insolvent, but we further respectfully submit that under the law as it exists, we have succeeded in so doing.

We also concede that the burden of proof is on Universal to prove that its money had been misappropriated by Richfield, and that in fact a trust relationship existed rather than that of debtor and creditor. This phase of the matter has been *entirely removed* from the case, however, by the stipulation of appellants that Richfield misappropriated from Universal a net sum of $1,625,000, and that such misappropriation was such as to constitute Richfield *the trustee of a constructive trust in which Universal was the beneficiary.* [Tr. p. 97.]

The burden was also upon Universal to prove, where the trustee has not kept the trust funds separately, into what fund his money had gone. But the facts in the instant case are not in any dispute. The moneys appropriated by Richfield from Universal went *directly* into the Richfield bank account. From this account certain *identified properties* were purchased, and the amounts paid for these properties are not in dispute. [Tr. p. 102 *et seq.*] The doubts that existed in *Peters v. Bain* and *Schuyler v. Littlefield, supra,* are not present in the instant case.

The bank account was dissipated a few days before receivership, and consequently Universal, under the es-

tablished authorities, was precluded from going beyond that date in its attempt to trace its funds. [Tr. p. 98.]

As heretofore noted, and as conceded by appellants, the appellee would have had no difficulty in recovering its money if the amount involved had remained in the bank account of Richfield at the time of the receivership. No reason suggests itself why additional burdens should be imposed upon Universal merely because Richfield substituted for the trust money in the commingled fund certain specified items of property.

With the foregoing facts stipulated or proved, the appellee has made out a *prima facie* case, and is in a position to rest. At this juncture appellee was entitled to a lien on the property purchased with the money of appellee that went into the property.

The duty of going forward with the evidence from this point was on Richfield, and it was up to Richfield to prove, if it could, that it was its own funds that purchased the particular properties rather than those of Universal. There is an utter dearth of testimony on this point, for Richfield failed to offer any evidence on this matter whatsoever.

As stated in a headnote by the court in the case of *Central National Bank v. Connecticut Mutual Life Insurance Co.,* 104 U. S. 54, 26 Law. Ed. 693:

> "That, so long as trust property can be traced and followed into other property into which it has been converted, the latter remains subject to the trust, and

that if a man mixes trust funds with his own, the whole will be treated as the trust property, *except so far as he may be able to distinguish what is his own,* are established doctrines of equity and apply in every case of a trust relation, and to moneys deposited in a bank account, and the debt thereby created, as well as to every other description of property." (26 L. Ed. 694.)

The Supreme Court of Texas reached the same result in *Meyers v. Baylor University,* 6 S. W. (2d) 393 (Court of Civil Appeals of Texas), where it is stated:

> "It is quite true that the burden of proof was upon plaintiff to establish the trust, but when proof of the fiduciary relationship of the parties was made, the betrayal of the trust, and probable amount of the embezzlements shown, a *prima facie* case was presented, and the burden was then on Meyers to show, if he could, that his money, and not that of the plaintiff, paid for the properties in whole or in part. Meyers was in possession of the exact facts, and it was his duty to reveal the entire truth. As he did not testify, and made no explanation of this matter, every intendment is against him." (6 S. W. (2d) 394, 395.)

See, also:

Israel v. Woodruff, 299 Fed. 454 (C. C. A. 2);

In re J. M. Acheson Co., 170 Fed. 427 (C. C. A. 9);

Smith v. Mottley, 150 Fed. 266 (C. C. A. 6);

Kineon v. Bonsall, 185 N. Y. S. 694. Aff. 134 N. E. 598;

Spencer v. Pettit, 17 S. W. (2d) 1102 (Tex.).

This does not mean that the burden of proof does not rest with the *cestui* throughout the case. If the trustee produces *any* evidence to show that it was his money that went into the property, the *cestui* must then show, by a preponderance of the evidence, that trust funds were used in the purchases. This distinction was clearly pointed out by Judge Rudkin in the case of *American Surety Co. v. Jackson,* 24 Fed. (2d) 768 (C. C. A. 9), where he says:

> "It will thus be seen that the rule itself rests largely on a legal fiction. But, if there is a presumption that trust funds have not been wrongfully misapplied or criminally used by the officers of the bank, as held by this court in the Spokane County case, *supra,* and such a presumption no doubt obtains, it would seem to follow as a necessary corrollary that the *burden was on the bank* or its successor in interest *to prove* that the trust funds or some part of them were in fact wrongfully misappropriated or criminally used by the bank. This presumption in nowise conflicts with the rule that in the end the claimant must trace the funds and establish his claim thereto by clear and satisfactory proof as against the receiver who represents all creditors." (24 Fed. (2d) 770.)

Appellants in urging that the burden of proof rested upon the *cestui* through the whole case, overlook the very obvious qualification of the rule pointed out in the case just cited by us.

In commenting upon this latter case, and others cited by us, they point out that the case involved merely the tracing of funds into a commingled fund. We submit that there is no equitable principle that requires the rule to be changed when the trust funds are being traced into property bought with, and substituted for, that commingled fund. The same rule of equitable estoppel that precludes the trustee from claiming the balance in the bank account as his own, applies with equal force and vigor to estop the defaulting trustee in claiming that the property purchased from the commingled fund is his property alone. To do otherwise is to penalize an innocent party with a resulting gain to the wrongdoer.

If appellants contend that Universal is required to earmark each dollar that came from the commingled fund, and to prove that the *identical* coin which Richfield took from it was used in the purchase of the specific property, we reply that the law throws no such *aegis* around the rascality of faithless trustees.

III.

The Right of Universal to Trace Its Money Is Limited by the Lowest Balance Reached by the Richfield Bank Account Between the Date of Misappropriation and the Date of the Purchase of the Property.

Although certain authorities approve the doctrine that subsequent deposits will be considered as replenishments of the trust fund, we have at no time sought to establish this doctrine, which we believe to be opposed to the weight of authority.

At all times during the trial of this action, Universal has recognized that the law limited its right to claim its funds from the account of Richfield in the Security Bank to the lowest balance reached by that account subsequent to the misappropriations.

In re Hallett, supra;

Schuyler v. Littlefield, supra;

First National Bank v. Fidelity, 48 Fed. (2d) 585.

Appellants contend that the presumption established by the *Hallett* case, namely, that the first moneys withdrawn are those of the trustee, prevents the recovery of Universal. However, as has been heretofore demonstrated, that rule applies only when the funds withdrawn are dissipated by the trustee. When he uses the moneys withdrawn to make investment in property which he retains, those investments are *substituted for the commingled fund and may be claimed by the cestui.*

As pointed out by Professor A. W. Scott in his article, *"Money Wrongfully Mingled With Other Money,"* 25 Harvard Law Review 125, 132:

"It so happened that in the earlier cases the part first withdrawn from the commingled fund was invariably dissipated, and the claimant wished to establish an interest in the remainder, which interest he was allowed, as has been stated, on the ground that it is presumed that the wrongdoer withdraws his own money first. But when the part first withdrawn is invested or otherwise preserved, and the remainder is dissipated, *the application of that presumption would throw a loss on the claimant.*"

In the note in 82 *A. L. R.*, at page 160, the author states:

"The fiction in question was invented for the benefit of the *cestui que trust* in cases where his trust money is commingled with the funds of the trustee, and it should not be followed to its logical conclusion where to do so would *defeat* recovery in a case no less meritorious than those in which it is employed in the aid of a recovery. *There should be consistency in results rather than merely in the steps employed in reaching a result.*"

(a) The Proper Minimum Balance That Should Have Been Used by the Special Master and the District Court Was Either the Closing Daily Balance or the Lowest Posted Balance.

Appellants in their brief, page 65 *et seq.*, would have this court adopt the conclusions of the Special Master on the amount of the minimum balances, in the event that it was proper to impress a trust on the property purchased by Richfield; thus disregarding the lowest daily closing balances and posted balances.

To avoid the use of the lowest daily closing balances, counsel rely entirely on the case of *In re Brown,* 193 Fed. 24 (C. C. A. 2nd). We do not at this point discuss this case, as it is discussed in our brief as cross-appellant. We do, however, wish to emphasize here that the daily closing balances were used in the case of *Brennan v. Tillinghast,* 201 Fed. 609 (C. C. A. 6th).

In order to avoid the use by the Special Master of the lowest posted balances, we are somewhat surprised to find that appellants attribute to the Security Bank the statement that their posted balances were ". . . but the result of haphazard postings during the day." This effort of the Security Bank to avail itself of the possible difficulties imposed on Universal in connection with the posted balances seems to us, to say the least, to come in rather bad taste from that source.

We do not propose to duplicate the matters set forth in our brief as cross-appellant on the question of the proper minimum balance that should have been adopted by the Master. On these points we merely state our position in this matter, namely, that the Master should have used the lowest daily closing balances as the proper balances, or at the very minimum the lowest posted balances.

Conclusion.

Applying all the statements of general principles to the specific facts in the respective cases to which the principles refer, it will be seen that in the end they amount to the same thing. Whether the court presumes, in bank cases, that the first money taken out and dissipated is the trustee's own funds; whether the court throws the duty on the trustee of going forward with proof that his own

funds were used in the acquisition of assets; or whether the court presumes that invested money is the *cestui's* and the dissipated funds are those of the trustee, they all in their reasoning revert to one basic principle.

That principle is that when trust funds and personal funds of the trustee are once shown to have been inextricably commingled in a common bank account, the *cestui* has a lien on the whole of the commingled fund, and on every asset that can be shown to have been purchased with the commingled funds.

A great deal of the disparity of statement of principle arises from the attempts of the courts to conceive of the existence of two separate funds, but the result arrived at in all of them, regardless of the principle stated, is that there is but one fund on which, and on the property purchased therewith, the *cestui* holds a lien. This lien follows all the property purchased, regardless of the amount invested, subject to the limitation, of course, that when the *cestui* is made whole the lien ends.

The trustee cannot be heard to say that all of the money that went into the purchase of these assets was his own, and that all funds which he had belonging to the *cestui* were dissipated by him. Furthermore, the trustee, under well-recognized principles, should be compelled to do equity. As the Master aptly stated in his report:

> "Another rule, equally appealing to the conscience, should have effect: the rule which requires the fiduciary, in such a case, *to do equity*. Nothing could be more abhorrent to the conscience than that the fiduci-

> ary should set aside to himself the gain and to his beneficiary the loss. *The difficulty is created by himself; the burden of it should be on him.* To do equity, *he must concede the first fruits to the beneficiary.* Before he can be heard at all, he must be required to do so." [Tr. p. 179.]

The facts in this case are without any confusion—the salient ones being either stipulated or being conclusively shown by undisputed evidence. The doctrine of the case of *In re Oatway* fully supports our position, and this doctrine has been adopted and approved by every well considered case that has had an analogous situation.

There can be no doubt but that in decreeing a lien in favor of Universal for its misappropriated funds, the Special Master acted correctly; but we feel that the only error committed by the Special Master was in the theory adopted of what was the proper minimum balance to use. We respectfully refer this court to our brief as cross-appellant in this case where we have fully developed, and we feel demonstrated, that the Special Master should have used the lowest daily closing balance, or, as the very minimum, the lowest posted balances.

Respectfully submitted,

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